United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

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UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

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In the Matter of

INVESTORS FUNDING CORPORATION OF
NEW YORK, et al.,

Debtors,

PLS

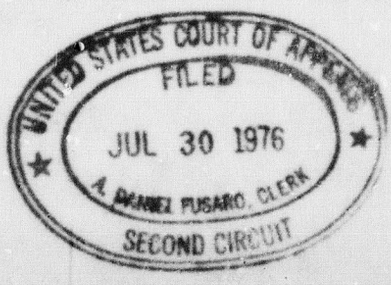
JAYTEE-PENNDEL COMPANY,

Appellant.

On Appeal from the United States
District Court for the Southern District
of New York

APPELLEE'S BRIEF

WEIL, GOTSHAL & MANGES
Attorneys for Appellee
767 Fifth Avenue
New York, New York 10011
(212) 758-7800



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ISSUES PRESENTED FOR REVIEW

1. Has the appellant shown that the District Court abused its discretion in staying a state court action against a reorganization trustee appointed under Chapter X of the Bankruptcy Act, where said action sought to reform the terms and diminish the value of a property interest held by the reorganization debtor.

2. Does 28 U.S.C. §959(a) authorize a state court action brought against a reorganization trustee appointed under Chapter X of the Bankruptcy Act, where said action seeks to reform the terms of the reorganization debtor's property interest?

3. Has the appellant shown that the District Court abused its discretion in providing for a compromise procedure for payment of amounts admittedly due the Trustee on the reorganization debtor's mortgage?

STATEMENT OF THE CASE

Appellant, Jaytee-Penndel Co. ("Jaytee") is the owner of certain real property located in Bucks County, Pennsylvania ("the Property"). Appellee, James Bloor ("the Trustee"), is the Reorganization Trustee of IFC Collateral Corporation ("Collateral"), a debtor in proceedings for the reorganization of a corporation pursuant to Chapter X of the Bankruptcy Act ("the Act") and the holder of a "wraparound" mortgage on the Property. Jaytee appeals herein from an order of the United States District Court for the Southern District of New York (Dudley B. Bonsal, J.), which (1) restrained and stayed Jaytee from continuing the prosecution of an action it had brought against the Trustee in the Supreme Court of the State of New York, County of Rockland, seeking to "reform and recast" in drastic fashion the terms of Collateral's mortgage, and (2) provided for a procedure by which certain payments admittedly due and payable from Jaytee to the Trustee under the terms of the mortgage should be made.

FACTS

A. The Parties

Prior to June 29, 1972, Jaytee's predecessor in interest, Pennledge Apartment Corporation ("Pennledge"), owned the Property, subject to a first mortgage held by the Buffalo Savings Bank ("Buffalo"). On June 29, 1972, Pennledge executed and delivered a wraparound mortgage to Realty Equities Country-

wide, Inc., which in turn assigned its rights under the wraparound mortgage to Collateral. Subsequently, Jaytee purchased the Property from Pennledge, with full notice of and subject to the terms and conditions of both the Buffalo first mortgage and Collateral's wraparound mortgage (Supp. App. 26; App. 31).*

On October 21, 1974, Collateral and its parent corporation filed in the District Court their respective voluntary petitions for Reorganization under the provisions of Chapter X of the Act.** On October 30, 1974, the District Court entered an order enjoining and staying all persons from commencing and continuing any suits against the debtor corporations, including Collateral (Supp. App. 1). On November 1, 1974, the District Court appointed the appellee, James Bloor, as Reorganization Trustee of Collateral and the other debtor corporations (Supp. App. 10). The Trustee duly qualified on November 5, 1974.

B. The Mortgages

The financing device of a wraparound mortgage is generally used where the real property involved is already

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* Citations to the Supplemental Appendix submitted by the Trustee will be indicated herein as "Supp. App. ____". Citations to the Appendix submitted by Jaytee will be indicated as "App. ____".

** Thirty-two other subsidiaries of the parent corporation filed a joint Chapter X petition with the District Court on October 30, 1974.

subject to a first mortgage and additional financing is desired by the owner, but a traditional second mortgage would provide the prospective lender with neither sufficient return nor adequate protection to make the transaction economically attractive. In the case at bar, the total original obligation of Jaytee's predecessor, Pennledge, under the wraparound mortgage was $1,543,097.81(App. 4), with interest at 7-3/4% per annum, but this principal amount included or "wrapped in" the outstanding balance of the Buffalo first mortgage in the amount of $1,196,329.99. Under this arrangement, each month Pennledge, and thereafter Jaytee, paid Collateral the entire amount due on the wraparound mortgage, including interest on the entire amount at 7-3/4% per annum. Out of that sum, Collateral paid monthly the amount due on the first mortgage (including interest on the outstanding balance of the first mortgage at 6% per annum) by sending such amount to Buffalo (Supp. App. 12). The wraparound mortgage thus can be an attractive device to lenders, and presumably was attractive to Realty Equities and thereafter Collateral, because (1) Collateral is entitled to receive the 1-1/4% difference between the interest due on the full amount of the wraparound mortgage and that due on the Buffalo first mortgage (Supp. App. 12), and (2) the monthly amount of amortization of the Buffalo first mortgage was significantly greater than the amount of amortization of the wraparound mortgage, thus continuously increasing Collateral's

equity in the wraparound mortgage by the difference. Moreover, when the Buffalo mortgage matures and is liquidated (in 1987), the wraparound mortgage will become a first mortgage without any prior or wrapped-in mortgage, Jaytee will thereafter continue to pay Collateral the same constant monthly payment until 1992 and Collateral will be entitled to retain the entire amount of the mortgage payments from Jaytee, without paying any part thereof to Buffalo.

C. The Dispute

Prior to November 1974, Pennledge, and thereafter Jaytee, made monthly payments to Collateral of the entire amount due on the wraparound mortgage and from that sum Collateral forwarded to Buffalo the lesser amount due on the first mortgage (Supp. App. 13). The November 1974, monthly payment to Collateral, which was received on or about November 6, 1974 (Supp. App. 13), arrived, however, shortly after Collateral had filed its petition in Reorganization in the District Court and only one day after the Trustee had qualified and was beginning to familiarize himself with the complex operations of the various debtors.* In the confusion that prevailed in its offices at that time, Collateral inadvertently failed to forward the November payment due to Buffalo on the first mortgage until

* The reorganization proceeding in which Collateral is one of the debtors constitutes one of the largest and most complex group of such cases in history.

November 18, 1974 (Supp. App. 13), three days after the expiration of the "grace period" for payment.

Meanwhile, on or about November 15, 1974, Jaytee had been informed by Buffalo that the November payment on the first mortgage had not been received and to avoid a default, Jaytee also forwarded the payment, together with a 4% late charge of $517.36 (App. 31-32; Supp. App. 13).*

Paragraph 35 of the wraparound mortgage provides that, in the event the wraparound mortgagee is late in making payment to the first mortgagee, the mortgagor can pay the amount due directly to the first mortgagee and deduct that amount from his next payment to the wraparound mortgagee. Accordingly, when Collateral was told by Buffalo that Jaytee had already made the November 1974 payment, the Trustee requested that Buffalo accept his payment as the December payment. Buffalo returned the payment, however, and informed the Trustee that it would not accept any future payment from Collateral (App. 32).

Since November 1974, Jaytee has failed and refused to make any further payments due to Collateral under the wraparound mortgage, although it has apparently been paying Buffalo directly on the first mortgage (App. 33).

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* The Trustee has repeatedly offered reimbursement of this $517.36 late charge paid by Jaytee. Indeed, even in the order appealed from, the late charge was deducted from the amount due to Collateral.

D. The Proceedings Below

In or about May 1975, Jaytee commenced an action in the Supreme Court of the State of New York, County of Rockland, against the Trustee (the "Rockland County Suit") (App. 3). Relying on the late November payment, the suit sought to "reform and recast" the wraparound mortgage so as to "unwrap" the underlying first mortgage. In effect, this would turn the wraparound mortgage into an ordinary second mortgage, substantially diminishing the value of Collateral's interest therein (App. 34).*

The Trustee made application to the District Court for a restraining order enjoining the continuation of the Rockland County Suit and also seeking leave to retain special counsel in Pennsylvania -- the situs of the property -- to commence a foreclosure action on its wraparound mortgage (Supp. App. 9). He also asked that Jaytee be required to raise all its claims and defenses in the foreclosure action so that all the issues concerning the wraparound mortgage could be resolved in a single proceeding. Judge Bonsal granted a temporary restraining order and scheduled a hearing on the Trustee's application.

Prior to the first hearing before the Court, Jaytee filed an "Affidavit in Opposition" to the Trustee's application,

* Over the life of the wraparound mortgage, converting this mortgage into a simple second mortgage would deprive Collateral of approximately $700,000 in interest and principal.

sworn to by its general partner (Supp. App. 38). It did not deny that the amounts claimed by the Trustee under the wrap-around mortgage were in fact due and pointed to no damage actually suffered by reason of the Trustee's one late payment to Buffalo, other than the late charge which the Trustee has offered to reimburse.

On October 20, 1975 the first of three hearings took place and all the issues were presented and argued before the Court by counsel (Supp. App. 44). The Court, apparently recognizing that continued litigation of this issue would merely cause additional expense to all concerned, encouraged a compromise between the parties, but despite extensive negotiations during the next two months, no agreement was reached. Meanwhile, Jaytee made no payments due Collateral under the terms of the wraparound mortgage. On January 19, 1976 the parties again appeared before Judge Bonsal; again all issues were discussed and again no agreement was reached (Supp. App. 70).

The compromise suggested by the Court in the first hearing and thereafter contemplated Jaytee forwarding two checks to the Trustee -- one payable to Buffalo for the amount due under the first mortgage and a second payable to the Trustee in the amount due to Collateral on account of the wraparound mortgage. The Trustee would, in turn, forward the Buffalo check. By this proposed compromise, the Court

attempted to protect the rights of all concerned: the Trustee would have retained Collateral's wraparound mortgage and would know that the first mortgage was being paid on a current basis, and Jaytee would not have had to rely on the Trustee to service the first mortgage (Supp. App. 53-69).* This compromise ultimately broke down over the issue of attorney's fees: Jaytee insisted that the Trustee agree to reimburse it for attorney's fees, despite the Court's suggestion that all questions of the recoverability and amount of attorney's fees be determined by a referee (Supp. App. 87-91, 93-95).

A third and final hearing was held before Judge Bonsal on February 17, 1976. The Trustee presented testimony, but Jaytee failed to produce a witness, although it had been notified that the Trustee had requested such testimony. The issues were presented and the Court directed the Trustee to settle an order and Jaytee to file any objections thereto or settle a counter-order if it so desired. The Court also advised counsel for Jaytee that he could submit a brief on all the legal issues he deemed relevant (App. 44-46). The Trustee settled its order on three weeks' notice. However, Jaytee submitted neither a counter-order nor a brief and the District Court signed the Trustee's order (App. 13-21).

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* As the transcripts of the three hearings before Judge Bonsal make clear, Jaytee always recognized that it was obligated to pay to the Trustee the amounts due on the wraparound mortgage since November 1974 (See, e.g., Supp. App. 56, 79-80; App. 39-40).

E. The Order

In the Order signed by the District Court, the relief requested by the Trustee in his Application was not granted in full. The Trustee had sought leave to commence a foreclosure proceeding due to Jaytee's failure to make any payments on account of the wraparound mortgage since November 1974. Instead, Judge Bonsal attempted to accommodate the needs of all the parties: in order to protect the assets of Collateral, he stayed the prosecution of the Rockland County Suit; at the same time, however, he gave Jaytee all the protection it had said in open court that it desired.

Jaytee had claimed that it needed protection against a recurrence of the November 1974 event and an assurance that future payments on the first mortgage would be made by the Trustee.* Accordingly, the Order provides (¶3) that payment to Buffalo on account of the first mortgage would be made by Jaytee sending a check, payable to Buffalo, to the Trustee who, in turn, would be required to forward it to Buffalo and notify Jaytee of its transmittal (¶4). Thus, both the Trustee

* As evidenced by counsel's comments at the first hearing before Judge Bonsal, Jaytee was apparently attempting to use the Trustee's inadvertant delay in making one payment in 1974 as an excuse to eliminate any wraparound mortgage because it felt that such a mortgage was financially disadvantageous (Supp. App. 65-66). Of course, the property had already been subject to the wraparound mortgage at the time Jaytee acquired its interest in the property.

and Jaytee would be in a position to know that the first mortgage has been paid. Similarly, counsel for Jaytee had claimed that it was entitled to recover its attorneys fees and other damages resulting from the dispute. Accordingly, the Order provided (¶12) that either Jaytee or the Trustee could apply for such relief. The Order was, by its terms, limited to the time period when Jaytee and Collateral retained their present interests in the property (¶8) in order to avoid any long-range prejudice to either party. Finally, the Order provided (¶10), in lieu of allowing the Trustee to foreclose, that Jaytee pay to the Trustee the amounts it admitted it owed on account of the wraparound mortgage since November 1974.

ARGUMENT

POINT I

JAYTEE HAS NOT SHOWN THAT THE DISTRICT COURT ABUSED ITS DISCRETION IN STAYING THE ROCKLAND COUNTY SUIT

A. The Reorganization Court has Discretion to Stay a State Court Action Against the Trustee

In reorganization proceedings under Chapter X of the Act, the District Court, sitting as a court of bankruptcy, has the same jurisdiction, powers and duties as in a bankruptcy proceeding upon adjudication. Section 114 of the Act, 11 U.S.C. §514. The court thus has the broad equitable power to "cause the estates of [debtors] to be collected, reduced to money, and distributed, and determine controversies in relation thereto . . . ." Section 2a(7) of the Act, 11 U.S.C. §11a(7). However, in reorganization proceedings under Chapter X, Congress specifically vested the court with additional powers with respect to lawsuits against the debtor or its trustee. Section 116(4) of the Act, 11 U.S.C. §516(4), provides as follows:

> "Section 116. Upon the approval of a petition, the Judge may, in addition to the jurisdiction, powers and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court --
>
> * * *
>
> (4) In addition to the relief provided by Section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor." (Emphasis supplied).

As this Court held in Drincup Vendors, Inc. v. Fountain Machines, Inc., 134 F.2d 823 (2d Cir. 1943), referring to the District Court's refusal to lift its general stay order to permit a suit against a debtor in reorganization,

> "In Chapter X proceedings the district judge has discretion to stay all suits against the debtor. 11 U.S.C.A. §516(4). We can upset the stay only if discretion was abused."

The Court has the same discretion to stay suits against the Trustee. The scope of the District Court's jurisdiction and discretion in such proceedings was comprehensively outlined in Diners Club, Inc. v. Bumb, 421 F.2d 396 at 398 (9th Cir. 1970):

> "Upon the filing of the petition, all property in the possession of the debtor passed into the custody of the reorganization court, and became subject to its authority and control. In the exercise of its jurisdiction over the debtor's property, the court had power to issue injunctions and all other writs necessary to protect the estate from interference and to ensure its orderly administration....
>
> This ancillary jurisdiction of the reorganization court flows not only from express provisions of statute, Bankruptcy Act §§ 2(a)(15), 114-16, 11 U.S.C. §§ 11(a)(15), 514-16; All Writs Act, 28 U.S.C. § 1651, but from the inherent power of a court of equity to protect its control of a res in its custody.... It extends to the stay of proceedings in other courts, Bankruptcy Act § 116(4), 11 U.S.C. § 516 (4), whenever such stays are necessary to conserve the assets of the estate,... or to

> prevent interference with the orderly rehabilitation of the debtor corporation. It is not limited by the federal anti-injunction act, 28 U.S.C. §2283,... but may be exercised in the sound discretion of the reorganization judge." (Emphasis supplied) (citations omitted)

In addition, Section 111 of the Act, 11 U.S.C. § 511, vests the Bankruptcy Court with "exclusive jurisdiction of the debtor and its property, wherever located". There can be no doubt, of course, that a mortgage interest in real property constitutes "property" within the meaning of this section and is subject to the summary jurisdiction of the Bankruptcy Court. In re Westec, 460 F.2d 1139, 1143 (5th Cir. 1972).

Having the power to stay the Rockland County Suit, the District Court properly exercised its discretion to do so. Although Jaytee failed to point to any contractual obligation between itself and the Trustee which was violated by the three-day delay in making the November payment to Buffalo, and alleged no real damage it had suffered (except perhaps for the $517 late fee it paid to Buffalo), its complaint in the Rockland County Suit demanded broad and drastic relief that would substantially diminish the value of Collateral's estate. It asked the State Court to "reform and recast" the Trustee's wraparound mortgage in the principal amount of approximately $1,543,000 and convert it into a separate "second, subordinate mortgage in the

reduced amount of $369,623.40." If such relief were granted, Collateral's estate (1) would lose the 1-1/4% per annum interest differential it was receiving from Jaytee over and above the interest payable on the Buffalo first mortgage, (2) would be deprived of the continuing increase in its equity in the wraparound mortgage which would arise from the fact that the Buffalo mortgage amortizes more rapidly than the wraparound mortgage, and (3) would lose the benefit of the right to retain the entire amount of each monthly payment on the wraparound mortgage after the retirement of the Buffalo mortgage in 1987.

In addition, permitting the Rockland County Suit to proceed would expose Collateral's estate to the unnecessary expense of duplicative litigation and the possibility of inconsistent judgments, since the Trustee would have to defend the Rockland County Suit but could not seek foreclosure in Rockland County on account of Jaytee's failure to make its payments on the wraparound mortgage. Such a foreclosure action would, of course, have to be brought in Pennsylvania. Brisbane v. Pennsylvania R.R., 205 N.Y. 431 (1912).

B. 28 U.S.C. § 959 Does Not Limit the District Court's Power to Stay the Rockland County Suit

Jaytee contends that 28 U.S.C. § 959(a) overrides the general principles of reorganization jurisdiction and deprives the court of any discretion to stay a state court

action. That section (of which Jaytee has only quoted the first sentence on page 8 of its brief) provides as follows:

> "Trustees, receivers, or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same shall be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury." (Emphasis supplied).

In Diners Club, Inc. v. Bumb, supra, the Ninth Circuit rejected precisely the same argument Jaytee makes here. In referring to Section 959(a), the court held that "the first sentence's broad grant of permission to sue is limited by the second, which makes suits subject to the general equity power of the appointing court." 421 F.2d at 398. It distinguished those cases (some of which are relied upon by Jaytee) in which a blanket injunction, issued at the time of appointment of a trustee and staying all suits against the debtor or his property, had been read as not barring a suit permitted by the first sentence of Section 959(a):

> "The same cannot be said of an injunction issued after the bringing of a suit, and based upon a determination that such a suit would significantly interfere with the administration of the estate. The latter represents an exercise of the court's equitable jurisdication that is not simply ancillary to the appointment of the receiver or trustee, but necessary, in the sound discretion of the court, for the protection and achievement of the goals for which the receivership or reorganization proceeding was instituted." 421 F.2d at 401.

After holding that "in the exercise of a sound discretion, the judge of the reorganization court has the power to enjoin the continuation of a suit in another court -- even a suit within the purview of § 959(a)" (Id.), the court in Diner's Club found on the specific facts before it that the state action in question should not have been enjoined, since a fund had been created from which Diner's Club's claim could be paid without embarrassing the administration of the estate. But in the case at bar, Jaytee's suit would clearly have a substantial and deleterious effect on Collateral's rights and on the value of its asset, the wraparound mortgage which Jaytee seeks to "reform". In addition, had the stay not been granted, the Trustee would have been forced to litigate essentially the same facts in both the Rockland County Suit and in a foreclosure action in Pennsylvania (the only forum in which he could seek foreclosure). This would involve unnecessary duplication, wasted time and substantial amounts of money for legal fees.*

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* The other cases cited by Jaytee at page 9 of its brief -- Sherr v. Sierra Trading Corp, 492 F.2d 971 (10th Cir. 1974); Leonard v. Vrooman, 383 F.2d 556 (9th Cir. 1967); and Novo Enzyme Corp. v. Baker, 361 F.Supp. 337 (S.D.N.Y. 1973) -- are irrelevant to the question of whether the District Court had the discretion to stay the state court action, even assuming Section 959(a) applies (see Point II, infra).

Appellant's reliance on Thompson v. Texas Mexican Railway Co., 328 U.S. 134 (1946), is entirely misplaced. In that case, the Supreme Court recognized the right of the Texas Mexican Railway to bring suit against the reorganization trustee despite the pro forma general stay of suits which had been issued early in the reorganization proceeding (not a stay directed specifically at the lawsuit in question). It expressly based its decision in this regard, however, on the fact that (1) the "main purpose" of Texas Mexican's suit was to recover damages, (2) the alleged obligation sued upon was only a "personal" obligation and did not purport to grant the debtor in reorganization any interest in the property of Texas Mexican, and (3) the recovery of damages only would not interfere with the administration of the estate. 328 U.S. 139-141. By contrast, in the case at bar, the "main purpose" of Jaytee's Rockland County Suit was not to recover damages or a sum of money (indeed, Jaytee did not even seek recovery there of the $517 late fee it paid to Buffalo). Rather, it sought only broad equitable relief which would drastically modify a property interest of the reorganization debtor. As is clear from the Thompson opinion itself, where the claim arises from a contract which grants the reorganization debtor a property interest, a suit to effect its forfeiture or to modify its terms "could not be maintained in another court

without consent of the reorganization court." Id. at 140.*

POINT II

THE AUTHORITY TO SUE GRANTED BY SECTION 959(a) DOES NOT APPLY TO THE ROCKLAND COUNTY SUIT

As noted above, a reorganization debtor's mortgage lien is a property interest subject to the jurisdiction of the Bankruptcy Court. In re Westec Corp., supra. In the Rockland County Suit, Jaytee is seeking to reform the wrap-around mortgage in a way that would alter it substantially and diminish Collateral's rights thereunder. Such actions against property within the Bankruptcy Court's jurisdiction are not permissible under Section 959.** See Field v. Kansas City Refining Co., 9 F.2d 213 (8th Cir. 1925), cert. denied, 271 U.S. 676 (1926); Field v. Kansas City Refining Co., 296 F.800

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* In re Mercy-Douglass Hospital, Inc., 364 F.Supp. 1066 (E.D. Pa. 1973), cited on page 11 of Jaytee's brief, is irrelevant to Jaytee's contentions. There the court held that after a creditor had already obtained a state court judgment and attachment, the attachment could be dissolved, but the state court judgment could not be vacated as the state court had concurrent jurisdiction. This holding in no way implies that it would have been improper to have enjoined the creditor from continuing the state action before a judgment was entered in the state court.

** In fact, Chapter X Rule 10-701(2) expressly provides that a proceeding to "determine the validity, priority or extent of a lien or other interest in property" is an "adversary proceeding" governed by "Part VII of the Bankruptcy Rules."

(8th Cir.), cert. denied 266 U.S. 618 (1924); J. I. Case Plow Works v. Finks, 81 F.529 (5th Cir. 1897); In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974); American Brake Shoe & Foundry Co. v. Interborough Rapid Trans. Co., 10 F.Supp. 512 (S.D.N.Y.), aff'd per curiam, 76 F.2d 1002 (2d Cir.), cert. denied, 295 U.S. 760 (1935); Dickinson v. Willis, 239 F.171 (S.D. Iowa 1916); Love v. Louisville & E.R. Co., 178 F.507 (W.D. Ky. 1910).

In American Brake Shoe & Foundry Co. v. Interborough Rapid Transit Co., supra, the court held that the predecessor to Section 959 did not contemplate the allowance of suits, such as the Rockland County Suit, intended to directly affect liens or possessory rights in the res subject to the Bankruptcy Court's jurisdiction.

> "As uniformly interpreted by the courts, [the] sole purpose [of 28 U.S.C. § 959] is to make federal receivers amenable to state court suits on causes of action arising out of the ordinary operation of the company in receivership. Actions for personal injuries caused by the negligent operation of a common carrier are a familiar example. Gableman v. Peoria, Decatur and Evansville R.R. Co., 179 U.S. 335, 21 S.Ct. 171, 45 L.Ed. 220 (1900). On the other hand, causes directly affecting the administration of the receivership res, or property rights therein, do not fall within the provision; to allow such suits to be instituted without leave of the court which has the property in its custody would divest it of its exclusive jurisdiction thereover and lead but to conflict and confusion in administration. Such was not the legislative purpose." 10 F.Supp. at 518. (Emphasis supplied.)

See also Ex parte Baldwin, 291 U.S. 610, 615-16 (1934).

Moreover, Section 959(a) and its predecessor statutes were intended to create a narrow exception to the general rule that lawsuits against receivers or trustees in bankruptcy could not be brought without leave of the court. Vass v. Conron Bros. Co., 59 F.2d 969, 970 (2d Cir. 1932)*. This exception was limited to those actions against receivers, trustees or debtors-in-possession which are directly related to their acts or transactions in "carrying on business" connected with the property entrusted to them. See Austrian v. Williams, 216 F.2d 278, 285 (2d Cir. 1954), cert. denied, 348 U.S. 953 (1955); Vass v. Conron Bros. Co., supra; In re American Associated Systems, Inc., supra; see also 1 Collier, Bankruptcy, ¶2.36[1] at 247-49 (14th ed. 1974). The allegations of the complaint in the Rockland County Suit do not in any way relate to or arise from an act of the Trustee in "carrying on business" connected with the debtor's property. Consequently, Jaytee's state court action does not fall within the ambit of the statute.

In Vass v. Conron Bros. Co., supra, the bankrupt had operated a cold meat storage plant and had leased to Conron Bros. Co. a portion of the premises, which it had

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* As noted in Point I above, however, this exception is still subject to the Bankruptcy Court's summary power to stay such suits.

agreed to refrigerate. After the trustee in bankruptcy affirmed the lease, Conron alleged that the trustee failed to refrigerate the premises properly, causing the goods to spoil. Conron then commenced an action in the state court relying upon 28 U.S.C. § 125, the predecessor to Section 959, contending that the trustee's assumption of the bankrupt's lease made him amenable to suit. This Court rejected Conron's contention, however, and affirmed the Bankruptcy Court's order staying the prosecution of the state court action. The Court held that Conron's claim did not arise from an "act or transaction" of the trustee in carrying on the business of the bankrupt and set forth guidelines for determining what actions may be taken by a trustee without exposing himself to such suits.

> "To carry on the business is, we should think, the same thing as to continue it under section 2(5) of the Bankruptcy Act, 11 USCA § 11(5); it must involve enough to require an order of court. [Citations omitted.] Merely to hold matters in status quo; to mark time, as it were; to do only what is necessary to hold the assets intact; such activities do not seem to us to be a continuance of the business." 59 F.2d at 971. [Emphasis supplied.]

In the case at bar, at the beginning of November 1974, the Trustee had just been appointed, had barely completed the legal steps necessary to qualify as trustee, and was engaged in determining the nature of the debtors' businesses and the nature and extent of their assets and liabilities. He was

not yet actively engaged in the day-to-day operations of those businesses. Thus, the Trustee's failure to make the November 1974 mortgage payment earlier than November 18, 1974 should not be construed as "carrying on business" under Section 959. The Trustee's action -- or more precisely, his temporary inaction -- if anything, was a mere "marking of time" which did not involve any business act or transaction.

Jaytee places heavy reliance on Reading Co. v. Brown, 391 U.S. 471 (1968), to support its assertion that "for the purposes of a Reorganization, collecting rent from the debtor's property is sufficient to constitute the 'carrying on of a business'." (Jaytee's Brief, p. 13). However, in Reading Co., the issue was not whether the trustee was "carrying on business" within the meaning of Section 959(a). Rather, it was simply whether certain claims against the trustee, based on fire damage caused by the trustee's admitted negligence during the period of his Chapter XI receivership prior to adjudication, were entitled to priority as administration expenses. As stated by the court, the question was "whether the negligence of a receiver administering an estate under a Chapter XI arrangement gives rise to an 'actual and necessary' cost of operating the debtor's business" under §64(a)(1) of the Bankruptcy Act.

Jaytee also cites City of New York v. Patton, 390 F.Supp. 1001 (S.D.N.Y. 1975) and Novo Enzyme Corp. v. Baker,

supra, in support of its position. Neither decision relates to the question of whether the Trustee was "carrying on business" within the meaning of Section 959(a). In those cases the court held that a blanket injunction issued pro forma at the beginning of a railroad reorganization was ineffective to prevent a breach of contract suit. However, both courts noted that the reorganization courts were free to exercise their equitable powers under Section 959(a) to enjoin specific suits against the trustees. In fact, in Patton, Judge Werker stated that "that Reorganization Court may now wish to exercise its powers under 28 U.S.C. 959(a) to enjoin this suit". 390 F. Supp. at 1003.

POINT III

JAYTEE HAS NOT SHOWN THAT THE DISTRICT COURT ABUSED ITS DISCRETION IN PROVIDING FOR A COMPROMISE PROCEDURE FOR PAYMENT OF AMOUNTS ADMITTEDLY DUE ON THE WRAPAROUND MORTGAGE

The Reorganization Court has exclusive jurisdiction of the debtor and its property, wherever located. Section 111 of the Act, 11 U.S.C. § 511. It also has jurisdiction to cause the estate of bankrupts to be collected and to determine controversies in relation thereto. Section 2a(7) of the Act, 11 U.S.C. § 11a(7). This jurisdiction may be exercised summarily, rather than in a plenary action, where the property is in the actual or constructive

possession of the court or its appointed trustee or where there is no bona fide claim adverse to the trustee's interest in the res. The scope of the Bankruptcy Court's summary jurisdiction was succinctly described by the Supreme Court in Cline v. Kaplan, 323 U.S. 97 (1944) at 98-99:

> "A bankruptcy court has the power to adjudicate summarily rights and claims to property which is in the actual or constructive possession of the court. Thompson v. Magnolia Co., 309 U.S. 478, 481. If the property is not in the court's possession and a third person asserts a bona fide claim adverse to the receiver or trustee in bankruptcy, he has the right to have the merits of his claim adjudicated 'in suits of the ordinary character, with the rights and remedies incident thereto.' Galbraith v. Vallely, 256 U.S. 46, 50; Taubel-Scott-Kitzmiller Co. v. Fox, 264 U.S. 426. But the mere assertion of an adverse claim does not oust a court of bankruptcy of its jurisdiction. Harrison v. Chamberlin, 271 U.S. 191, 194. It has both the power and the duty to examine a claim adverse to the bankrupt estate to the extent of ascertaining whether the claim is ingenuous and substantial. Louisville Trust Co. v. Comingor, 184 U.S. 18, 25-26." (Emphasis supplied.)

In May v. Henderson, 268 U.S. 111 (1925) at 116, the court stated this principal even more strongly:

> "The court has jurisdiction to inquire into the claim for the purpose of ascertaining whether the summary remedy is an appropriate one within the principles of decision here stated. Mueller v. Nugent, supra; Schweer v. Brown, 130 Fed. 328, 195, U.S. 171; Herbert v. Crawford, 228 U.S. 204; In re Ellis Bros. Printing Co., 156 Fed. 430. It may disregard the assertion that the claim is adverse if on the undisputed facts it appears to be merely colorable. In re Weinger, Bergman &

> Co., 126 Fed. 875; In re Rudnick & Co., 158 Fed. 223; In re Ransford, 194 Fed. 658; Michaelis v. Lindeman, 196 Fed. 718." (Emphasis supplied.)

Accord, Teasdale v. Robinson, 290 F.2d 108, 110-11 (8th Cir. 1961); In re Southern Metal Products Corporation, 26 F. Supp. 666, 670 (N.D. Ala. 1939).

In the case at bar, the res under consideration by Judge Bonsal was the wraparound mortgage held by Collateral, which was certainly a property interest in the actual possession of the Trustee. In addition, Jaytee made no claim adverse to the title or property interest of either Collateral or the Trustee. At no time during the proceeding did Jaytee deny that Collateral held a valid wraparound mortgage, that Jaytee was in default on its payments on that mortgage and that under the terms of the mortgage monies were due and owing to the Trustee. In fact, Jaytee's counsel in open court specifically conceded the approximate amount that was due and owing (Supp. App. 81-82). Thus, there is no "adverse claim" with respect to the wraparound mortgage on which Jaytee can challenge the District Court's summary jurisdiction.

In reorganization proceedings under Chapter X of the Act, the attempt to rehabilitate the debtor brings into play additional considerations and even more reason for vesting the court with broad discretion in disposing of disputes which affect the debtor's property.

"It is, therefore, generally vital to the success of a reorganization that all the debtor's property be included, that the continuation of the debtor's business be not unduly hampered by dissipation of the property to particular creditors, or by the separate administration of the estate in numerous forums." 6 Collier, Bankruptcy, ¶ 3.05 at 442 (1965). (Emphasis supplied.)

"Under bankruptcy powers, the District Court, upon the filing . . . of the petition under 77 B of the Bankruptcy Act [now Chapter X], obtains exclusive jurisdiction over the debtor and the property wherever located . . . ; including authority to determine all controversies with regard to the same, to marshall the assets, to determine all issues, settle claims and to do all other things necessary or incident to a complete administration of the assets and the estate. It is the purpose of the amendment, as a remedial act, to afford a speedier, more efficient means for reorganization of embarrassed corporations than formerly existed, the elimination of multiplicitous litigation and the prevention of delay. In exerting jurisdiction under the same, the court sits as in equity and is governed by equitable principles." Matter of Utilities Power and Light Corp., 90 F.2d 798 (7th Cir. 1937), cert. den. sub. nom. Associated Investing Corp. v. Utilities Power and Light Corp., 302 U.S. 742 (1937).

In the exercise of its equitable jurisdiction, the court may sift the circumstances surrounding any claim in order to ascertain that injustice or unfairness is not accomplished in the administration of the debtor's estate. In so doing, it may adopt that remedy which it deems most appropriate under the circumstances. In re Los Angeles Lumber Products Co., Ltd., 46 F. Supp. 77, 92 (S.D. Cal. 1941); 6 Collier, Bankruptcy, ¶ 3.17 at 536 (1965). Since (1)

Jaytee had raised no substantial claim adverse to Collateral's property interest in the wraparound mortgage, (2) no material facts were in dispute, and (3) the parties were already properly subject to the summary jurisdiction of the Reorganization Court (see Points I and II above), the District Court was entirely justified in assuming summary jurisdiction not only to stay the Rockland County Suit but to attempt to fashion a remedy which would be just and fair to both sides without embarrassing or impeding the administration of Collateral's estate. The District Court had the discretion, if not the duty, to balance the equities and to seek a resolution of the controversy.

The dispute came before the District Court by reason of Jaytee's contention that it had a contractual relationship with the Trustee which the Trustee violated. Accepting this contention arguendo, then Jaytee cannot avoid the summary jurisdiction of the Bankruptcy Court, including an order to pay over monies due and owing.

> "The general principle of law relied upon by the Referee that 'one who contracts with a trustee or receiver in bankruptcy contracts with the court itself and submits himself to the jurisdiction of that court for all purposes flowing out of the contract' is well supported. Governor Clinton v. Knott, 120 F.2d 149, 152 (2d Cir. 1941); In re Hollingsworth and Whitney Co., 242 F. 753, 756-757 (1st Cir. 1917); Jackson v. Moore, 348 F.2d 437, 441 (5th Cir. 1965); In re California Eastern Airways, Inc. 95 F. Supp. 348, 351 (Del., 1951); Mason v. Wolkowich, 150 F. 699, 700-701 (st Cir. 1906); and In re Sobod, Inc. 25 F. Supp. 344, 345-346 (S.D.N.Y., 1938)." In re F. W. Koenecke & Sons, Inc., 369 F. Supp. 558, 561 (N.D. Ill. 1973).

Once jurisdiction was acquired by the District Court, it was retained for all purposes, including the entry of an order directing Jaytee to pay money to the Trustee. Governor Clinton Co. v. Knott, 120 F.2d 149, 153 (2d Cir. 1941); In re F. W. Koenecke & Sons, Inc., supra.

Had the District Court simply stayed Jaytee's Rockland County Suit and permitted the Trustee to commence foreclosure proceedings in Pennsylvania, there would be no question that he was completely within his power and discretion. Had he done so, Jaytee would have been faced with almost certain foreclosure and probable loss of its property, since it had admittedly defaulted on the wraparound mortgage. However, the Court sought to dispose of the controversy equitably and gave Jaytee several important protections: (1) he prevented the Trustee from commencing foreclosure proceedings, (2) he directed that in the future Jaytee make its payments on the wraparound mortgage in two separate checks, one payable to the Trustee and the other payable to Buffalo, and (3) he left Jaytee free to assert a later claim for damages if it saw fit. As part of this total disposition, the Court also directed that Jaytee pay past amounts due the Trustee. Certainly, this result was fair and reasonable and considerably more favorable to Jaytee than it would have been had the Court simply allowed the Trustee to foreclose and left it at that.

CONCLUSION

The order of the District Court should be affirmed in its entirety.

Dated: New York, New York
July 30, 1976

Respectfully Submitted,

WEIL, GOTSHAL & MANGES
Attorneys for Appellee
767 Fifth Avenue
New York, New York 10022

ALAN B. MILLER
JOHN M. SCHWARTZ
PRUDENCE B. ABRAM
NEAL SCHWARZFELD,

Of Counsel

STATUTES INVOLVED

Section 2a(7) of the Bankruptcy Act, 11 U.S.C. §11a(7):

> §2. Creation of Courts of Bankruptcy and Their Jurisdiction. a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to--
>
> * * *
>
> (7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;

Section 111 of the Bankruptcy Act, 11 U.S.C. §511:

> Sec. 111. Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

Sections 114, 115 and 116(4) of the Bankruptcy Act, 11 U.S.C. 514, 515 and 516(4):

> Sec. 114. Upon the approval of a petition, the jurisdiction, powers, and duties of the court and of its officers, where not inconsistent with the provisions of this chapter, shall be the same as in a bankruptcy proceeding upon adjudication.
>
> Sec. 115. Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.
>
> Sec. 116. Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court--
>
> * * *
>
> (4) in addition to the relief provided by section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

28 U.S.C. §959(a):

> (a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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In the Matter of INVESTORS FUNDING CORP. OF NEW YORK, et al.,

Debtors,

JAYTEE-PENNDEL COMPANY

Appellant.

----------x

Docket No. 76-5019

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
ss.:
COUNTY OF NEW YORK)

JOHN M. SCHWARTZ, being duly sworn, deposes and says:

I am not a party to this action, I am over 18 years of age and reside in New York, New York. On July 29, 1976, I served two true copies of Appellee's Brief and one true copy of Appellee's Supplemental Appendix by mailing the same in a sealed envelope, with postage prepaid thereon, in an official depository of the United States Postal Service within the State of New York, addressed to Dennis G. Katz, P.C., the attorney for the appellant herein, at his office address at 300 North Main Street, Spring Valley, New York 10977.

John M. Schwartz

Sworn to before me this
30th day of July, 1976.

Kevin P. Hughes
Notary Public

KEVIN P. HUGHES
Notary Public, State of New York
No. 30-6999450
Qualified in Nassau County
Commission Expires March 30, 1978